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February 11, 2005

EX PARTE

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: **In the Matter of IP-enabled Services, WC Docket No. 04-36; Level 3 Communications Petition for Forbearance, WC Docket No. 03-266**

Dear Ms. Dortch:

Please file the attached in the record for the above-referenced proceedings. Please contact me if you have any questions.

Sincerely,

/s/Kathleen Grillo

Attachment

cc: Christopher Libertelli
Jennifer Manner
Jessica Rosenworcel
Dan Gonzalez
Scott Bergmann
Jeffrey Carlisle
Michelle Carey
Lisa Gelb
Austin Schlick
Tamara Preiss
Steve Morris
Jennifer McKee
Jeremy Marcus
Julie Veach
Jeff Dygert
Russ Hanser
Chris Killion

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Level 3 Communications LLC	)	
	)	
Petition for Forbearance Under 47	)	WC Docket No. 03-266
U.S.C § 160(c) From Enforcement of 47	)	
U.S.C. § 251(g), Rule 51.701(b)(1), and	)	
Rule 69.5(b)	)	

LEVEL 3'S FORBEARANCE PETITION SHOULD BE DENIED

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February 11, 2005

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I. INTRODUCTION

In this proceeding, Level 3 attempts to use Section 10 of the Communications Act as a device for creating brand new rules to govern the compensation that local telephone companies receive when voice long distance calls originate or terminate on the public switched telephone network. In particular, Level 3 seeks to replace the current access charge regime with an entirely novel reciprocal compensation scheme that would grant preferential treatment to only one type of voice long distance calls that use the public switched telephone network ("PSTN") – namely, those that originate, or in some cases terminate, in voice over Internet protocol ("VoIP") over a broadband connection on the other end of the call. Level 3's Petition must be denied.

As an initial matter, it is important to be clear about the issue here. The issue is not whether VoIP services offered by Level 3 or any other provider should be regulated. They should not. Both VoIP services and the broadband services and facilities on which they ride are offered by multiple providers, and, as the Commission has recognized, are highly competitive. Accordingly, neither should be regulated.

The sole issue here is whether local exchange carriers should receive the same compensation as they do for all other voice long distance calls when a call happens to originate in VoIP format before it is converted to TDM and delivered over the public switched network in precisely the same manner as any other voice long distance call. The Commission, of course, has repeatedly emphasized that traffic that uses the public switched network in the same way should be subject to the same compensation. As the Commission explained in the IP-Enabled Services NPRM, "the cost of the PSTN should be borne equitably among those that use it in similar ways."

Level 3 nonetheless argues that the Commission should "forbear" from the access charge rules that apply to every other type of voice long distance call, and, instead, subject local exchange carriers to a more intrusive regulatory regime that would assign to state commissions the job of prescribing the rates they may charge to carry this traffic based on TELRIC.

First, Level 3's petition is not a request to remove regulation. The Commission's access charge rules do not regulate Level 3 or any other VoIP provider. Instead, they regulate the rates that local exchange carriers charge to carry voice long distance calls. Accordingly, if the Commission were to forbear from applying these rules in the case of interexchange VoIP calls, it would mean the rates that local exchange carriers charge to deliver these calls would no longer be regulated. From a policy perspective, there are good reasons that true forbearance would make sense. It would allow local exchange carriers and VoIP providers to negotiate a rate for this traffic, with the current interstate access rates that the Commission previously found to be "just and reasonable" presumably still available as a default.

But Level 3 does not ask the Commission simply to forbear from the current rules that regulate local exchange carrier rates. Instead, it asks the Commission to impose a different and more intrusive rate regulation regime. That is not the stuff of forbearance. That is the stuff of rulemakings, and Level 3's "forbearance" petition must be denied for that reason alone.

Moreover, the Commission today has jurisdiction to determine the appropriate compensation scheme for all interstate traffic under section 201 of the Act. But the particular approach urged by Level 3, which for the first time would reinterpret the reciprocal compensation provision of the Act to extend to interstate interexchange traffic, would relinquish authority to set the rates that apply to the exchange of VoIP traffic and assign it to the states. That not only would conflict with the Commission's efforts to establish a preemptive federal regime for VoIP traffic by assigning authority over a key issue to the states, but it also would confound the Commission's broader efforts to establish a unitary federal intercarrier compensation regime.

The approach urged by Level 3 also would produce a number of additional harmful, and, from the Commission's standpoint, presumably unintended consequences. For example, because of the interaction between the Commission's various rules, and in particular those governing ISP-bound traffic, the approach urged by Level 3 would inflate reciprocal compensation payments on ISP-bound calls and reinstate the "uneconomic arbitrage" that the Commission worked assiduously to eliminate. In addition, the approach urged by Level 3 is designed to prescribe TELRIC-based access rates for VoIP long distance calls that use local exchange carriers' switching, and to preclude consideration of more reasonable alternatives. The Commission, however, rejected a proposal by Level 3 to set access rates at TELRIC once before, and doing so now for one particular type of traffic would merely replicate the problems created by TELRIC-priced switching generally. As several commissioners have pointedly noted, TELRIC-priced switching itself results in uneconomic "subsidies." And the Commission only recently decided to eliminate that requirement, recognizing that it deterred investment and deployment by all providers of competing facilities.

In addition, granting Level 3's Petition would mean that local exchange carriers would receive substantially lower compensation from some providers of voice long distance service than others, based solely on the fact that their services employ a different transmission protocol *before* being converted and handed off for delivery on the PSTN in the same manner as any other long distance call. This disparity undermines the Commission's fundamental "belie[f] that any service provider that sends traffic to the PSTN should be subject to similar compensation obligations, irrespective of whether the traffic originates on the PSTN, on an IP network, or on a cable network" and that "the cost of the PSTN should be borne equitably among those that use it in similar ways."

Level 3's petition also raises a host of other interrelated issues, many of which are currently being examined in other proceedings, that would have to be squarely addressed in order to come to a reasoned decision here. For example, the Commission would have to address whether slashing the rates that local exchange carriers may charge to originate and terminate long distance traffic to TELRIC levels would result in rates that are just, reasonable and not confiscatory. And it would have to address the broader consequences of adopting the approach urged by Level 3 for long term intercarrier compensation reform and for universal service. That is not something that can be accomplished in a forbearance proceeding.

In short, as is discussed in detail below, Level 3's petition is not an appropriate subject for forbearance, nor are the statutory forbearance criteria met even if they were to be applied in this case. As such, the petition must be denied.

II. BACKGROUND

A. Switched Access Charges And The Telecommunications Act Of 1996.

Following the breakup of the Bell System into separate long distance and local telephone companies, this Commission and state regulators established access charges, which long distance carriers pay to local telephone companies when using their local network facilities to complete interexchange calls. Long distance carriers pay access charges to originating and terminating local exchange carriers.

Access charges were designed to recover costs of the local telephone network that, before the breakup of the Bell System, had been recovered through voice long distance rates. The Commission in 1983 adopted rules for switched access charges to "provide for the recovery of the incumbent LECs' costs assigned to the interstate jurisdiction by the separations rules."[1] State regulators followed suit, using access charges to compensate LECs for a portion of the costs associated with operating local exchange and exchange access networks that were assigned to the intrastate jurisdiction. Access charges are one of the mechanisms created by regulators to permit local exchange carriers to recover the costs of their local network that are assigned the interstate and intrastate jurisdictions respectively, as required by Supreme Court precedent.[2]

Initially, access charges were predominantly usage-sensitive (as long distance charges had been), based on the Commission's judgment that those who used the network the most should pay a larger portion of the costs, and reflecting a policy determination that costs should be recovered in a way that kept fixed end user charges affordable. Over time, a portion of those charges gradually have been converted into fixed end-user charges, while another portion continues to be recovered on a usage sensitive basis.[3] Access charges thus have been a key component of regulators' efforts to promote universal service by providing a mechanism to recover part of the cost of a ubiquitous local phone network from the customers who use it the most. For that reason, as Chairman Powell has explained to Congress, the Commission has "fully recognize[d] the gravity of any decision that might cause a precipitous decline in access charge revenues and a concomitant impact on universal service."[4]

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1 *Access Charge Reform*, 12 FCC Rcd 15,982, 15,991 (¶ 21) (1997) ("*Access Charge Reform Order*").

2 *See Smith v. Illinois Bell Tel. Co*., 282 U.S. 133, 149, 160 (1930).

3 *Access Charge Reform Order*, 12 FCC Rcd at 15,991-92 (¶¶ 21-22). Until a few years ago, a portion of loop costs was recovered through the usage-sensitive carrier common line charge. The *Access Charge Reform Order* phased out that rate structure. *See id*. at 15,998-16,000 (¶¶ 37-40).

4 Written Statement of Michael K. Powell, Chairman, Federal Communications Commission, on Voice over Internet Protocol (VoIP), before the Senate Committee on Commerce, Science and Transportation, at 15 (Feb. 24, 2004) ("*Powell VoIP Statement*").

1. Interstate access charges.

Interstate switched access charge rates have declined dramatically over the past twenty years. In 1984 – the year the AT&T monopoly was broken up – these charges averaged more than 17 cents per minute on an interstate long distance call.[5] Today, the largest ILECs charge roughly half a penny per minute at each end of an interstate call.[6]

The Commission used various mechanisms to regulate switched access rates over time and has expressly found that the rates currently in effect are just and reasonable. First, from 1983 through 1990, ILEC access charges were subject to rate of return regulation. Under this approach, "incumbent LECs calculate the specific access charge rates using projected costs and projected demand for access services. An incumbent LEC is limited to recovering its costs plus a prescribed return on investment, and is potentially obligated to provide refunds if its interstate rate of return exceeds the authorized level."[7]

In 1991, the Commission shifted the largest ILECs from rate of return regulation to price cap regulation. The Commission used the final access charges it set under rate of return regulation as the basis of its new price cap access charges. It explained that "the rates resulting from the annual 1990 access proceeding represent the culmination of years of developing, refining, and overseeing the Commission's access charge system," and reflect "the best that rate-of-return regulation could produce."[8]

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5 *See* FCC Wireline Competition Bureau, *Trends in Telephone Service* at 1-6 (May 2004), *available at* http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/trend504.pdf.

6 *See id.*; *Access Charge Reform*, 15 FCC Rcd 12,962, 13,029 (¶ 162) (2000) ("*CALLS Order*") (establishing target rates of 0.55 cents for BOCs).

7 *CALLS Order*, 15 FCC Rcd at 12,968 (¶ 13).

8 *Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786, 6814 (¶ 232) (1990) ("*LEC Price Cap Order*").

Price cap regulation focuses on prices rather than costs. Under this system, access charges "have been limited . . . by price indices that have been adjusted annually pursuant to formulae set forth in our Part 61 rules." Indeed, since price caps were implemented, access rates have declined steadily due to a combination of the mechanics of the plan and the fact that "[p]rice cap regulation encourages incumbent LECs to improve their efficiency by harnessing profit-making incentives to reduce costs, invest efficiently in new plant and facilities, and develop and deploy innovative service offerings, while setting price ceilings at reasonable levels."[9] Shortly after passage of the 1996 Act, the Commission refined the price cap scheme by "reform[ing] the current rate structure to bring it into line with cost-causation principles" and "set[ting] in place a process to move the baseline rate level toward competitive levels."[10]

In 2000, the Commission sharply cut switched access charges further by approving the CALLS plan, which compensated for the reduction in switched access charges by allowing carriers to increase the federal subscriber line charges paid by end user customers. The CALLS plan was developed by "two groups representing historically opposing positions, *i.e.*, LECs (sellers of access services) and IXCs (buyers),"[11] who "negotiated with each other in good faith and fashioned a reasonable compromise that both addresses their competing interests and serves the broader public interest."[12] The resulting rates, the Commission found, "are just and reasonable [and] are within the range of estimated economic costs of switched access . . . ."[13]

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9 *CALLS Order*, 15 FCC Rcd at 12,968-69 (¶ 16).

10 *Access Charge Reform Order*, 12 FCC Rcd at 15,998 (¶ 35).

11 *CALLS Order*, 15 FCC Rcd at 12,981 (¶ 48).

12 *Id.*

13 *Id.* at 13,035 (¶ 176); *see also id.* at 12,974 (¶ 29) (indicating that the CALLS Plan "sets carrier charges at a reasonable level"); *id.* at 12,978 (¶ 41) ("The rates proposed by CALLS are reasonable."); *id.* at 12,981 (¶ 49) (concluding that the CALLS plan's "essential constituent parts individually fall within the range of reasonableness").

The Commission also stated that "the fact that both purchasers and suppliers of access services . . . supported the target rates further indicates that they are a reasonable temporary estimate of prices that might be set in a competitive market."[14] The Commission's judgment that the CALLS rates are reasonable was affirmed by the Fifth Circuit.[15]

2. Intrastate access charges.

As is true at the federal level, intrastate access charges have declined markedly over time and repeatedly have been found to be just and reasonable. Those charges are set by the various state regulatory commissions, and are designed to recover intrastate costs. A number of states have undertaken reform of intrastate access rates that parallel the steps taken by the Commission. In the states in which the vast majority of Verizon's (and all BOCs') access lines are located, intrastate access rates are subject to price cap schemes similar to the one used at the federal level. A minority of states regulate intrastate access charges using a detailed rate of return methodology, and access charges have declined significantly in those states as well. In each case, the state commissions have determined that their intrastate access charges are just and reasonable.[16]

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14 *Id.* at 13,035 (¶ 176).

15 *Tex. Office of Pub. Util. Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001), *cert. denied*, 535 U.S. 986 (2002).

16 *See, e.g.*, *Application of Verizon New Jersey for Approval (i) of a New Plan for Alternative Form of Regulation,* Docket No. TO01020095, Decision and Order at 39 (N.J.B.P.U. 2003) ("The Board therefore FINDS that rates under PAR-2, as modified herein, are and will remain just and reasonable") ; *Investigation by the Dep't of Telecomms. and Energy on its own Motion into the Appropriate Regulatory Plan to Succeed Price Cap Regulation for Verizon New England Inc., d/b/a Verizon Massachusetts*, D.T.E. 01-31-Phase I (May 8, 2002) (ordering the rates for intrastate switched access to be lowered to interstate levels); 35-A M.R.S.A. Section 7101-B (Maine) (requiring intrastate access charges to be set equal to interstate access charges as of Jan. 1, 2003); *see also* Docket No. 2003-358, *Investigation of Compliance of Verizon Maine with Amended 35-A M.R.S.A. Sec. 7101-B*, Order Establishing Schedule for Access Rate Reductions, Dec. 2, 2003 (implementing reductions in intrastate access rates to meet the Jan 1, 2003 interstate rate levels in two equal phases on June 1, 2004 and May 31, 2005).

Intrastate access charges continue to recover the costs of operating and maintaining local phone networks. That is, of course, necessary and appropriate. As the Commission has emphasized, "the cost of the PSTN should be borne equitably among those that use it in similar ways."[17] And intrastate access charges help to keep end user connection charges affordable, directly advancing the core universal service goal set forth in Section 254 of the Act.

3. The Enhanced Services Provider exemption.

When the Commission originally established the access charge regime, those charges applied to all interstate communications services that used the local network, including both "basic" and "enhanced" services.[18] The Commission, however, subsequently created an "exemption" for enhanced services from the access charges that would otherwise apply. While it has emphasized that enhanced services are "users of access" and that "the link that LECs provide to connect subscribers with ESPs is an interstate access service," it nonetheless has also concluded that enhanced service providers use the local network in a different way than long distance carriers.[19] According to the Commission, enhanced service providers use the local network in a way that is similar to typical business customers – namely, to communicate with and provide enhanced services to their own customers, rather than acting as a conduit for a telephone call between two end users in the way long distance carriers do.[20] The Commission therefore has "exempted" ESPs from paying per minute access charges, and allowed them "the

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17 *IP-Enabled Services*, 19 FCC Rcd 4863, 4904 (¶ 61) (2004) ("*IP-Enabled Services NPRM*").

18 *Access Charge Reform Order*, 12 FCC Rcd at 16,133 (¶ 345).

19 *ISP Remand Order*, 16 FCC Rcd at 9177 (¶¶ 55, 57).

20 *See Access Charge Reform Order*, 12 FCC Rcd at 16,133 (¶ 345) (acknowledging that "many of the characteristics of ISP traffic (such as large numbers of incoming calls to Internet service providers) may be shared by other classes of business customers").

option of purchasing interstate access services on a flat-rated basis from intrastate local business tariffs, rather than from interstate access tariffs used by IXCs."[21]

Since it first adopted the ESP exemption, the Commission has further clarified the services that fall within its scope. For example, the Commission has squarely held that services that involve a so-called "net protocol conversion" do not fall within the scope of the exemption when that conversion is "necessitated by the introduction" of new technology on a "piecemeal" basis in order to maintain compatibility with the existing network and equipment.[22] The Commission also has made clear that the use of new packet switching transmission protocols, of which Internet protocol is one type, likewise does not bring services within the scope of the exemption, despite the fact that a net protocol conversion is necessarily involved whenever a customer of a packet-switched service exchanges traffic with a customer of a circuit-switched service.[23] And it also has made clear that if a service that uses the local telephone network is not subject to the ESP exemption, access charges apply.[24]

4. The Telecommunications Act of 1996.

The 1996 Act was drafted and passed against the backdrop of this regulatory history of access charges. Indeed, Congress had a keen appreciation for the critical role that access charges play in recovering the costs of local phone networks and assuring universal service. The

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21 *Implementation of the Local Competition Provisions in the Telecomms. Act of 1996*, 16 FCC Rcd 9151, 9164 (¶ 27) (2001) (emphasis in original) ("*ISP Remand Order*"), *remanded*, *WorldCom v. FCC*, 288 F.3d 429 (D.C. Cir. 2002), *cert. denied*, 538 U.S. 1012 (2003).

22 *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, 12 FCC Rcd 2297, 2298 n.6 (¶ 105) (1997) (citations omitted).

23 *See Indep. Data Communications Mfrs. Ass'n, Inc., Pet. for Declaratory Ruling that AT&T's InterSpan Frame Relay Serv. Is a Basic Serv.*, 10 FCC Rcd 13,717, 13,722-23 (¶¶ 33-41) (1995) ("*AT&T Frame Relay Order*").

24 *Pet. for Declaratory Ruling that AT&T's Phone-to-Phone IP Telephony Servs. Are Exempt from Access Charges*, 19 FCC Rcd 7457, 7459 n.13 (¶ 4) (2004) ("*AT&T Phone-to-Phone IP Order*").

legislative history makes clear that "nothing in [the precursor to Section 251] is intended to affect the Commission's access charge rules."[25] As the Commission recognized, "Congress was concerned about the effects of potential disruption to the interstate access charge systems" and had similar "concerns about the effects on analogous intrastate mechanisms."[26]

While Congress obviously was aware that the FCC and the states had well established compensation regimes governing the exchange of interexchange traffic, there was not a comprehensive regime governing the exchange of local traffic. Shortly before the 1996 Act, however, a number of states had adopted new compensation regimes for the exchange of local traffic, while also carefully maintaining the existing access-charge regimes for interexchange calls.[27] These state commissions referred to the new compensation regime for the exchange of local traffic as "reciprocal compensation."

When Congress passed the 1996 Act against this backdrop, it too was careful to preserve the established access charge regimes for interexchange traffic, while creating a new reciprocal compensation scheme for local traffic. Congress did so both through the express terms of Section 251(b)(5), which created a new compensation mechanism for the exchange of *local*

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25 H.R. CONF. REP. NO. 104-458, at 117 (1996); *see also* S. REP. NO. 104-23, at 22 (1995).

26 *Implementation of the Local Competition Provisions in the Telecomms. Act of 1996*, 11 FCC Rcd 15,499, 15,869 (¶ 732) (1996) ("*Local Competition Order*"); *see also ISP Remand Order*, 16 FCC Rcd at 9168 (¶ 37) ("Congress did not intend to disrupt the[] pre-existing relationship.").

27 *See, e.g.*, *Order Instituting Rulemaking*, No. 95-12-056, 1995 Cal. PUC LEXIS 966, at *48-*49 (Dec. 20, 1995) (establishing "bill and keep for *local* calls," and requiring with respect to *interexchange* traffic that "CL[E]Cs will pay terminating access charges based on the LEC's existing switched access tariffs" (emphasis added)); *Pet. of MCI Telecomms. Corp.*, Nos. 39948 & 40130, 1995 Ind. PUC LEXIS 399, at *34 (Nov. 21, 1995) (establishing "the form and amount of compensation to be paid for completion of local calls between MCI's and Ameritech Indiana's respective networks"); *Illinois Bell Tel. Co.*, No. 94-0096, 1995 Ill. PUC LEXIS 230, at *208 (Apr. 7, 1995) (explaining that the Illinois commission adopted "one compensation structure for the termination of 'local' traffic and the existing switched access charges for the termination of all other traffic").

traffic, and through other provisions that confirm that Section 251(b)(5) was not intended to disrupt the existing access charge regime.

First, as the states commissions had done, when Congress adopted a new "reciprocal compensation" mechanism, it carefully limited that mechanism to *local* traffic exchanged by competing *local exchange carriers*. Unlike other provisions that apply to all telecommunications carriers (*e.g.*, Section 251(a)), Congress included this new provision in a section of the Act that applies exclusively to interconnecting "local exchange carrier[s]" (*i.e.*, Section 251(b)).[28] Congress also chose terms that both defined the nature of the traffic subject to this new mechanism and imposed specific requirements for any compensation arrangements for that traffic. Specifically, Congress made clear that the new compensation mechanism applied *only* to traffic that originates on the network of one LEC and terminates on the network of the interconnecting LEC. Thus, in Section 251(b)(5), Congress imposed obligations only on interconnecting LECs to establish "compensation arrangements for the *transport and termination* of telecommunications." Section 251(b)(5) also provides that these arrangements are to be "reciprocal," with each LEC obligated to enter into such arrangements with other LECs, which – unlike IXCs that typically do not terminate traffic but instead hand it off to another local exchange carrier on the distant end – would both "transport *and* terminat[e]" traffic received from the originating LEC. By its terms, therefore, Section 251(b)(5) excludes long distance traffic, which typically does not terminate on the network of an interconnecting LEC and, in

[28] *Local Competition Order*, 11 FCC Rcd at 15,994 (¶ 1001) (stressing that "Section 251(b) imposes duties *only* on LECs") (emphasis added); *see also* H.R. CONF. REP. NO. 104-458, at 121 (1996) (explaining that Section 251(b)(5) applies to "all local exchange carriers, including the 'new entrants' into the local exchange market").

many instances, is not exchanged with another LEC at all, but instead is exchanged with an IXC.[29]

Likewise, in the accompanying pricing provision in Section 252, Congress expressly provided that reciprocal compensation extends only to calls that "originate" on one LEC's network and "terminat[e]" on the interconnecting LEC's network.[30] Again, this language necessarily excludes interexchange calls, which are the subject of the access charge regime, because those calls typically are not handed from the originating LEC to an interconnected terminating LEC – rather, they traverse an interexchange carrier's network before being handed off to another local exchange carrier en route to their final destination. In addition, Congress provided that any reciprocal compensation arrangements adopted under these provisions were to provide for the "mutual" and "reciprocal" recovery of each carrier's costs.[31] It also made clear that any arrangements that did not provide, in some manner, for "mutual" cost recovery would be unjust and unreasonable.[32] Each of these provisions, by its terms, demonstrates that in Section 251(b)(5) Congress was creating a new compensation regime applicable only to local calls exchanged between interconnecting LECs, and not to interexchange calls subject to the well established access charge regimes.

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[29] *See Local Competition Order*, 11 FCC Rcd at 15,997 (¶ 1007). In the *Local Competition Order*, the Commission repeatedly recognized that § 251(b)(5) is limited to local traffic. *See id.* at 16,012 (¶ 1032) ("Congress intended to confine [§ 251(b)(5)] to local traffic."); *id.* at 16,013 (¶ 1033) ("The Act preserves the legal distinctions between charges for transport and termination of local traffic and interstate and intrastate charges for terminating long-distance traffic."); *id.* (¶ 1034) (concluding that "section 251(b)(5) reciprocal compensation obligations should apply only to traffic that originates and terminates within a local area").

[30] 47 U.S.C. § 252(d)(2)(A)(i) ("recovery by each carrier of costs associated with the transport and *termination on [its] network facilities* of calls that originate on the network facilities of the other carrier") (emphasis added); *id.* § 252(d)(2)(A)(ii) ("such terms and conditions determine such costs on the basis of a reasonable approximation of the additional costs of *terminating* such calls" (emphasis added)).

[31] *Id.* §§ 251(b)(5); 252(d)(2)(A)(i).

[32] *Id.* § 252(d)(2)(A).

Second, Congress further confirmed its intent not to alter the established access charge regime in other subsections of Section 251. For example, Section 251(g) requires LECs to continue providing "exchange access [and] information access . . . to interexchange carriers and information service providers" pursuant to existing "interconnection restrictions and obligations (including receipt of compensation) until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission." In addition, Section 251(i) states that "[n]othing in this section shall be construed to limit *or otherwise affect* the Commission's authority under section 201," which includes its authority to establish rates for interstate services. As explained in more detail below, because Section 251(b)(5) expressly assigns authority to set reciprocal compensation rates to the state commissions, subjecting VoIP traffic – which the Commission has held is jurisdictionally interstate – to Section 251(b)(5), would necessarily "limit" and "affect" the Commission's authority to set compensation for such traffic, contrary to Section 251(i).

The Commission itself has agreed with this construction of the Act's terms. In its original rulemaking proceeding to implement the 1996 Act, the Commission expressed concern that interpreting Section 251 to permit IXCs "to circumvent Part 69 access charges" would be "contrary to Congress' focus in th[at] section on promoting local competition" and "inconsistent with other provisions in section 251, such as sections 251(i) and 251(g)."[33] The Commission also recognized that interpreting Section 251 to apply to interexchange traffic subject to the established access charge regime would "effect a *fundamental jurisdictional shift* by placing interstate access charges under the administration of state commissions."[34] In its *Order* in that

[33] *Implementation of the Local Competition Provisions in the Telecomms. Act of 1996*, 11 FCC Rcd 14,171, 14,227-28 (¶ 164) (1996) ("*Local Competition NPRM*").

[34] *Id*. at 14,228 (¶ 164) (emphasis added).

same proceeding, therefore, the Commission held that the "Act preserves the legal distinctions between charges for transport and termination of local traffic and interstate and intrastate charges for terminating long distance traffic."[35] According to the Commission, "section 251(b)(5) reciprocal compensation obligations should apply only to traffic that originates and terminates within a local area," and "do[es] not apply to the transport or termination of interstate or intrastate interexchange traffic."[36] The Commission held that this "reading of the statute is confirmed" by the accompanying pricing provision in Section 252, which "provides for 'recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier.'"[37] Although numerous parties challenged various aspects of the *Local Competition Order*, this aspect of the Commission's *Order* was never challenged, let alone reversed.

Nor has the Commission concluded since that interexchange traffic falls within the scope of section 251(b)(5). In its *ISP Remand Order,* the Commission did note that section 251(b)(5) uses the broad term "telecommunications," and that *"[u]nless subject to further limitation*," would apply "whenever a local exchange carrier exchanges telecommunications traffic with another carrier."[38] But because the Commission found one such "further limitation" in the terms of section 251(g), and found that "ISP-bound traffic falls within at least one of the three enumerated categories in subsection (g),"[39] it had no occasion to re-examine whether any other statutory text similarly restricts "the universe of traffic that falls within subsection (b)(5)."[40] In

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35 *Local Competition Order*, 11 FCC Rcd at 16,013 (¶ 1033).

36 *Id*. at 16,013 (¶ 1034).

37 *Id*.

38 *ISP Remand Order*, 16 FCC Rcd at 9166 (¶ 32) (emphasis added).

39 *Id*. at 9167 (¶ 36).

40 *Id*. at 9166-67 (¶ 34).

particular, while the Commission "refrained from generically describing traffic as 'local' traffic" – in part "because the term 'local,' not being a statutorily defined category, is particularly susceptible to varying meanings and, significantly, is not a term used in section 251(b)(5) or section 251(g)"[41] – the Commission did not repudiate the analysis in the *Local Competition Order*, and has never held that interexchange traffic is subject to section 251(b)(5).

B. <u>Level 3's Petition For Forbearance.</u>

Level 3 uses the public switched telephone network to terminate calls in the same manner as any other interexchange carrier. In particular, to reach the called party, calls handled by Level 3 traverse the interoffice transport links, switches, and loops comprising the local exchange network. Yet Level 3 asks the Commission to "forbear" from applying the same just and reasonable access charges to Level 3's use of the public switched telephone network to originate or terminate its long distance traffic that apply to any other carrier's use of the PSTN to originate or terminate long distance traffic. Instead, Level 3 asks that the reciprocal compensation rules that govern the exchange of local traffic be extended to cover its long distance traffic.

The precise scope of Level 3's Petition is somewhat vague. Specifically, Level 3 requests "forbearance" from *terminating* access charges with respect to traffic that originates in IP format over a broadband connection and terminates on the PSTN. As initially filed, Level 3 also appeared to request forbearance with respect to traffic that originates on the PSTN and that terminates over a broadband connection in IP format. In a recent ex parte¸ however, Level 3 "clarified" that it is not seeking forbearance from *originating* access charges with respect to traffic that originates on the PSTN and is carried by a pre-subscribed or dial-around

41 *Id*.

interexchange carrier[42] before it is handed off to a VoIP provider for delivery. In any other routing scenario, however, Level 3's request for "forbearance" apparently applies to originating access as well as terminating. Level 3 has also requested forbearance from what it describes as "incidental" PSTN-to-PSTN traffic. Finally, the request covers both interstate and intrastate access.[43]

Level 3 suggests that the result of granting its Petition would be to reduce access charges to the TELRIC-based reciprocal compensation rates set by state commissions, but the true consequences would be even more extreme. This is a function of the Commission's rules governing ISP-bound traffic. Specifically, to obtain the benefits of the transitional steps set forth in the Commission's *ISP Remand Order*,[44] including the lower federal rate that applies to ISP-bound traffic, ILECs are required to accept payment for transporting and terminating traffic subject to Section 251(b)(5) under the same rate cap rule the Commission established under Section 201 for ISP-bound traffic. As a result, CLECs in the business of terminating VoIP calls would have the option of paying only $0.0007 per minute for such calls.

Alternatively, carriers that have interposed themselves between ILECs and ISPs, and therefore receive large volumes of ISP-bound traffic from originating LECs, could substantially increase the reciprocal compensation payments they receive on this traffic. Again, this is a function of the Commission's rules governing ISP-bound traffic. Those rules adopted a 3 to 1 ratio of outbound to inbound traffic for purposes of determining whether traffic is subject to compensation at reciprocal compensation rates or at the lower federal rate that applies to ISP-

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42 *See* Letter from John T. Nakahata, Counsel to Level 3 Communications LLC, to Marlene H. Dortch, Secretary, FCC, WC Dkt. No. 03-266 (Dec. 22, 2004) ("December 2004 *Ex Parte*").

43 In this White Paper, Verizon uses the phrase "VoIP traffic" to refer to the calls that Level 3 expressly includes within the scope of its Petition.

44 *ISP Remand Order*, 16 FCC Rcd at 9187 (¶ 78).

bound calls. Traffic above the 3 to 1 ratio is presumed to be ISP-bound traffic subject to the lower federal rate, while traffic below that ratio is presumed to be local traffic subject to reciprocal compensation. In its Petition, Level 3 asserts that VoIP traffic handed off to an ILEC counts toward the "1" in the 3 to 1 ratio, which has the effect of also inflating the volume of outbound traffic subject to reciprocal compensation. Thus, for each minute of VoIP traffic terminated to the ILEC, the intermediary CLEC would be paid the higher reciprocal compensation rates for three minutes of ISP-bound calls handed off to the CLEC. This would have the perverse effect of inflating the amount of intercarrier compensation paid by LECs for ISP-bound traffic and aggravating an arbitrage opportunity that the Commission has condemned as "distort[ing] competition by subsidizing one type of service at the expense of another."[45]

Finally, for any calls that originate on the PSTN and terminate as VoIP traffic that remain subject to Level 3's Petition, LECs would go from *receiving* originating access charges to *paying* reciprocal compensation.

III. THE RELIEF REQUESTED BY LEVEL 3 IS NOT AN APPROPRIATE SUBJECT FOR A FORBEARANCE PETITION.

At its core, Level 3's Petition is not a request to forbear from any regulations that apply to it or any other VoIP provider. Rather, it is a request to apply intrusive new regulations to the services provided by others – specifically, to sharply reduce the regulated rate that local exchange carriers may charge for use of their local networks to originate or terminate voice long distance traffic to TELRIC-based rates set in state proceedings. That request is not an appropriate subject for a forbearance petition. From a procedural standpoint, nothing in the Act allows Level 3 to petition to "forbear" from regulations that apply not to it but to others, or to impose even more onerous regulations in their place. And from a substantive standpoint, Level

[45] *Id.* at 9155 (¶ 5).

3's Petition raises a host of interrelated issues, and would result in a number of harmful consequences. Those issues must be squarely dealt with in order to reach a reasoned decision but are well beyond the scope of what can be addressed in the context of a forbearance proceeding.

A. As an initial matter, while the Commission has not had occasion previously to address squarely whether access charges apply to VoIP services such as those described by Level 3, the baseline presumption for purposes of the present Petition must be that access charges do apply. Indeed, although Level 3 denies that it has conceded that access charges apply to VoIP traffic, it has not asked for a declaratory ruling, nor would such a ruling be within the scope of the Commission's Public Notice here. Instead, Level 3 has asked only for "forbearance" from the Commission's access charge rules. Indeed, Level 3 itself appears to concede that, because of the limited scope of its Petition, access charges will continue to apply to VoIP traffic exchanged directly with rural carriers and, at least in some cases, to traffic that originates on the PSTN. So either Level 3 is being disingenuous and its Petition is merely the proverbial camel's nose under the tent and it will be back to claim that access charges do not apply in these cases either, or it recognizes that, despite its rhetoric, access charges do in fact apply.

In any event, while we will not belabor the point here because it is beyond the scope of Level 3's Petition, the fact is that access charges do apply to VoIP traffic under the Commission's Part 69 rules. These rules broadly define access services to include "services and facilities provided for the origination or termination of any interstate or foreign telecommunication," and require local exchange carriers to assess access charges on all "interexchange carriers" that use "local exchange switching facilities" to provide such services.[46]

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46 *See* 47 C.F.R. §§ 69.2(b), 69.5(b).

While there is no dispute that these terms apply to the voice long distance service that is the subject of Level 3's Petition, Level 3 nonetheless asserts that its service falls within the scope of the ESP exemption, and that it supposedly is exempt from paying the access charges that otherwise apply, because a so-called "net protocol conversion" is required when VoIP traffic is exchanged with the PSTN.

As noted above, however, the Commission has long made clear that services that involve net protocol conversions do not fall within the scope of the ESP exemption if the conversion is "necessitated by the introduction of new technology" that is "introduced piecemeal, and appropriate conversion equipment is used within the network to maintain compatibility."[47] Indeed, the paradigm example of such basic protocol conversion service – "a carrier-provided end office analog to digital conversion that permits an analog terminal to be accommodated by a network that is evolving to digital status,"[48] is directly analogous to VoIP traffic. Just as the network previously evolved from analog to digital, the network today is evolving from circuit-switched to IP technology, and carrier-provided protocol conversions are needed to permit IP terminals and equipment and TDM terminals and equipment to communicate with one another. In fact, the Commission itself previously found that packet switched transmission services – of

[47] *Amendment of Section 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry)*, 2 FCC Rcd 3072, 3082 (¶ 70) (1987) ("*Computer III Order*"), *vac'd on other grounds*, *California v. FCC*, 905 F.2d 1217 (9th Cir. 1990); *see also AT&T Phone-to-Phone IP Order*, 19 FCC Rcd at 7459 n.13 (¶ 4). There, the Commission explained that there are "three categories of protocol processing services that would be treated as basic services." Namely, "protocol processing: (1) involving communications between an end user and the network itself . . . (2) in connection with the introduction of a new basic network technology (which requires protocol conversion to maintain compatibility with existing CPE); and (3) involving internetworking . . . . The first and third identified categories of processing services result in no net protocol conversion to the end user." Plainly, then, the second category – the one relevant here – *does* involve a net protocol conversion but nonetheless is considered a basic telecommunications service, not an information service.

[48] *Computer III Order*, 2 FCC Rcd at 3082 (¶ 70).

which Internet protocol services are one type – are not inherently "enhanced."[49] And it did so despite the fact that a net protocol conversion necessarily is required for customers of packet-switched services to communicate with other customers served by the PSTN.

Nor is Level 3's service within the stated rationale for the ESP exemption. On the contrary, the Commission has justified the exemption on the theory that ESPs use the local network in a way that is analogous to local businesses – to communicate with and provide enhanced services to their own customers – rather than as a conduit for a voice telephone call between two end user customers.[50] Accordingly, "it is not clear that ISPs use the [public switched access] network in a manner analogous to the ways IXCs use it."[51] Here, in contrast, Level 3 *does* use the PSTN "in a manner analogous to IXCs" – to provide a transmission path between two people who wish to speak to one another. Accordingly, the ESP exemption is not applicable and access charges apply under existing rules.

B. From a procedural standpoint, Level 3's attempt to use Section 10 to apply different, more onerous rules to the compensation that local carriers receive for use of their networks is misplaced for two closely-related reasons.

First, the Commission's access charge rules regulate local exchange carriers – *not* Level 3 or any other VoIP provider – and the Act does not allow Level 3 to petition to forbear from regulations that apply to others. Specifically, the Commission's access charge rules prescribe the

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49 *See AT&T Frame Relay Order*, 10 FCC Rcd at 13,722-23 (¶ 41).

50 In other words, the ESP exemption is limited to an ISP's use of the PSTN to reach its own subscriber for the provision of an enhanced service. It does not apply when an ESP (or the CLEC serving the ESP) uses the PSTN to reach a non-subscriber who receives a voice long distance call from another end user – as happens in a VoIP-to-PSTN call.

51 Brief for the FCC at 71, *Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523 (8th Cir. 1998) (No. 97-2618) (internal quotations omitted); *see also Access Charge Reform Order*, 12 FCC Rcd at 16,133-35 (¶¶ 344-48).

rate levels that local exchange carriers are permitted to charge,[52] require local exchange carriers to file tariffs reflecting those rates,[53] prescribe the individual rate elements that local exchange carriers must charge,[54] and prescribe who local exchange carriers must assess those charges upon.[55] Likewise, the text of Section 251(g), which Level 3 also asks the Commission to forbear from, speaks of the "restrictions and obligations" that are applicable to "local exchange carrier[s]."[56] In each case, the entities being regulated are the local exchange carriers.

Neither the Commission's access charge rules nor Section 251(g) regulate Level 3 or any other VoIP provider, nor do they regulate any services they provide. The forbearance provisions of the Act, however, only entitle a carrier to request that the Commission forbear from "applying any regulation or any provision of this Act" insofar as it applies *"*with respect to *that carrier"* or "any service offered by *that carrier*."[57] It does not entitle Level 3 to petition to forbear from regulations that apply to some *other* provider or to some *other* provider's services.[58]

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52 *See* 47 C.F.R. § 69.1 (providing that rates are governed by price cap rules).

53 *See id*. § 69.3.

54 *See id*. § 69.5.

55 *See id*.

56 47 U.S.C. § 251(g).

57 *Id.* § 160(c) (emphasis added).

58 To the extent that Level 3 seeks relief from intrastate access charges, it does not explain how Section 10 confers authority upon the Commission to forbear from enforcing them. *See, e.g.*, Pet. for Forbearance of Level 3 Communications LLC, WC Dkt. No. 03-266, at iii (Dec. 23, 2003) ("Level 3 Pet.") (asking the Commission to "forbear from enforcing its governing statute and rules . . . to impose . . . intrastate access charges" on VoIP traffic (footnote omitted)); *id.* at vi (encouraging the Commission "to forbear from the application of . . . intrastate access charges" to VoIP traffic); *id*. at 10 (indicating that, if forbearance were granted, "intrastate switched access charges would not . . . apply" to VoIP traffic). Section 10 appears to grant the Commission authority to from its own regulations and from any provision of the Communications Act – "the Commission shall forbear from applying any regulation or any provision of this act" – but not to forbear from regulations over which it has no jurisdiction. *Id.* § 160(a). It is the states, not the FCC, that are charged with establishing intrastate access charges. *See* 47 U.S.C. § 152(b) (denying the Commission "jurisdiction with respect to . . . charges . . . for or in connection with intrastate communication").

Second, and more fundamentally, granting Level 3's Petition alone cannot provide the relief that Level 3 requests. Because the access charge rules limit the rates that local exchange carriers can charge for use of their networks, forbearing from those rules with respect to VoIP traffic would mean that those rates would no longer be regulated. By definition, to "forbear" means to "refrain from" or to "cease," and in this case to refrain from regulating.[59] Presumably, this would mean that VoIP providers and local exchange carriers could negotiate over the rates that would apply to this traffic, with any agreed upon rates to be reflected in amendments to existing tariffs.[60] While this may well be a sound result from a policy perspective, it obviously is very different from the highly regulatory result advocated by Level 3 in its Petition here.[61]

Level 3 also appears to recognize this fact. It therefore argues that the Commission not only should forbear from the rules that limit LECs' access charges, but should take additional

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[59] *See* BLACK'S LAW DICTIONARY 644 (6th ed. 1990) (defining "forbear" as "[r]efraining from doing something that one has a legal right to do")

[60] Level 3's Petition also fails to address the fact the LECs' existing tariffs (and interconnection agreements that incorporate those tariffs), require the payment of access charges to originate and terminate all interexchange calls, regardless of the provider. Accordingly, Level 3's Petition also could not have its intended effect unless the Commission invalidated these tariffs. In order to do so, the Commission would have to find that they are no longer lawful and that they are *not* just and reasonable. And, since the Commission cannot invalidate LECs' tariffs in a Section 10 forbearance proceeding, Level 3 cannot obtain the relief it is seeking through forbearance from the access charge rules alone. *See* Verizon Telephone Companies, Tariff F.C.C. No. 1, Switched Access Service, § 6, at 6.1 (Feb. 3, 2005) ("Switched Access Service provides for the ability to originate calls from an end user's premises to a customer's facilities, and to terminate calls from a customer's facilities to an end user's premises in the LATA where it is provided"); *id*. at 6.3.2.1(A) ("[Feature Group D] Access, which is available to all customers, provides trunkside access to Telephone Company end office switches . . . for the customer's use in originating . . . and terminating communications"). *See also* Interconnection Attachment to the Interconnection Agreement Between Verizon and US LEC of Florida, Inc. for Florida § 8.2 (effective Sept. 8, 2003) ("Subject to Section 8.1 above, interstate and intrastate Exchange Access, Information Access, exchange services for Exchange Access or Information Access, and Toll Traffic, shall be governed by the applicable provisions of this Agreement and applicable Tariffs.").

[61] Similarly, Level 3's recent request for exemption from retroactive liability, *see Ex Parte* Presentation of Level 3 Communications LLC, WC Dkt. No. 03-266, at 2-3 (Jan. 24, 2005) ("January 2005 *Ex Parte*"), further demonstrates that forbearance is an inappropriate vehicle here. Retroactivity analysis requires a balancing of equities and consideration of policy effects that Level 3 never raised in its Petition, and the retroactivity issue has not been fully briefed.

steps to *increase* the degree of regulation that currently applies to the LECs. Specifically, as discussed below, Level 3 wants the Commission to extend the reciprocal compensation regime for the first time to cover *interexchange* traffic. The result would be to move from the federal price cap scheme that currently applies to interstate traffic, to a more highly regulatory and intrusive regime where states prescribe TELRIC rates based on hypothetical cost models.[62] This not only would impose more onerous regulation on local exchange carriers, but it also would expand the state commissions' rate-setting authority to encompass an *interstate* service, thereby stripping the Commission of a core regulatory power, contrary to the Act.

Accordingly, Level 3's Petition asks the Commission to do far more than merely forbear from regulation. It also asks the Commission for the first time to impose other regulations that are far more intrusive, and would have far broader consequences than Level 3 admits. This is well beyond the scope of what the Commission can or rationally should do in the context of a forbearance proceeding.

Level 3's only answer to this is to claim that Section 251(b)(5) would automatically apply to VoIP traffic if the Commission grants its Petition to forbear from applying access charges. But its claim is misplaced. As outlined in the background section above and at greater length in Verizon's submissions in the ongoing proceeding on *ISP-Bound Traffic*, the terms of Section 251(b)(5) and its accompanying pricing provision, along with the history and background of the 1996 Act, confirm that Congress intended this Section to apply only to local traffic exchanged between interconnecting local exchange carriers, and *not* to interexchange traffic. Indeed, the Commission previously reached this very conclusion. In the *Local Competition Order*, the FCC

62 As noted above, while Level 3 represents that the effect of granting its Petition would be to apply TELRIC-based reciprocal compensation rates when VoIP traffic uses the PSTN, the actual impact would be far more severe because VoIP providers would have the option of paying the even lower $0.0007 rate that the Commission adopted for ISP-bound traffic.

recognized that "as a legal matter . . . transport and termination of local traffic are different services than access service for long distance telecommunications," and that "[t]he Act preserves the legal distinctions between charges for . . . local traffic and interstate and intrastate charges for terminating long-distance traffic."[63] As a result, Section 251(b)(5), as a matter of law, "do[es] not apply to the transport or termination of interstate or intrastate interexchange traffic."[64] That determination was never challenged, and, as explained above, the Commission has not concluded since that interexchange traffic does fall within the scope of Section 251(b)(5).

While Level 3 points to language in the *ISP Remand Order* that it says suggests that more than just local traffic is subject to Section 251(b)(5), the Commission there merely noted that the broad term "telecommunications" in that section, "*[u]nless subject to further limitation*," would apply "whenever a local exchange carrier exchanges telecommunications traffic with another carrier."[65] But the Commission found one such "further limitation" in the terms of Section 251(g), which it held "explicitly exempts certain telecommunications services from the reciprocal compensation obligations" imposed by Section 251(b)(5) – services that include "exchange access, information access, and exchange services for such access provided to IXCs and information service providers."[66] That same provision also preserved the Commission's rules that apply to those services, including those "governing receipt of compensation," until those rules "are explicitly superseded by regulations prescribed by the Commission" through appropriate rulemaking proceedings. Here, of course, access services for the origination and

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63 *Local Competition Order*, 11 FCC Rcd at 16,012-13 (¶ 1033).

64 *Id.* at 16,013 (¶ 1034).

65 *ISP Remand Order*, 16 FCC Rcd at 9166 (¶ 32) (emphasis added).

66 *Id.* at 9166 (¶ 32); *id*. at 9167 (¶ 36).

termination of voice long distance calls fall squarely within the scope of the rules preserved by Section 251(g).[67]

Moreover, having found one "further limitation" on the scope of Section 251(b)(5), the Commission had no reason to go on and re-examine its previous conclusion that other language in the statutory text of Section 251(b)(5) and its accompanying pricing provision also excludes interexchange traffic from the scope of Section 251(b)(5). The Commission did "refrain[] from generally describing traffic as 'local' traffic," in part because, unlike "exchange access," it is not a "statutorily defined category" and is "not a term used in Section 251(b)(5) or 251(g)."[68] But the Commission did not repudiate its determination in the *Local Competition Order*, and has never held that interexchange traffic is subject to Section 251(b)(5).

Accordingly, the Commission could not provide the relief requested by Level 3 without first repudiating its previous reasoned interpretations of Section 251(b)(5) and 251(g). That obviously goes far beyond the scope of what the Commission can do in a forbearance proceeding, and is not even an issue that the Commission has requested comment on here.[69]

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67 Level 3's claim that there were no "preexisting rules" governing VoIP traffic and therefore such traffic falls within Section 251(b)(5), not Section 251(g), *see* January 2005 *Ex Parte* at 3, is mistaken. As discussed above, VoIP traffic is interexchange, and therefore the origination or termination of such traffic on the PSTN is either exchange access or information access – categories that Level 3 concedes are covered by Section 251(g). *See* Level 3 Pet. at 5 (requesting that the Commission forbear from enforcing Section 251(g) "as it applies to the receipt of compensation for switched 'exchange access [and] information access'" (citation omitted)).

68 *ISP Remand Order*, 16 FCC Rcd at 9166-67 (¶ 34).

69 *See, e.g.*, *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Ins. Co.*, 463 U.S. 29, 42 (1983) (stressing that an agency may not "chang[e] its course" unless it "suppl[ies] a reasoned analysis for the change"); *Ramaprakash v. FAA*, 346 F.3d 1121, 1124 (D.C. Cir. 2003) (emphasizing that "agency action is arbitrary and capricious if it departs from agency precedent without explanation"); *Columbia Broad. Sys. v. FCC*, 454 F.2d 1018, 1027 (D.C. Cir. 1971) (holding that an unexplained policy shift constitutes "an inexcusable departure from the essential requirement of reasoned decision making"); *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970) (holding that an agency engages in arbitrary and capricious action whenever it "casually ignore[s]" its own "prior policies and standards"). Even if the Commission could expand the scope of section 251(b)(5), it could only implement the changes that Level 3 proposes

C. From a substantive standpoint, the issues raised by Level 3's Petition are inextricably interrelated to a host of issues currently pending before the Commission in other proceedings, and would either prejudge those issues or otherwise have far broader consequences than Level 3 admits. For that reason, the Commission could not grant Level 3's Petition until it first addresses the many ramifications of doing so, and any attempt to do so would be arbitrary and capricious.

1. As an initial matter, if the Commission grants Level 3's Petition, it would have the unintended side effect of dramatically reducing the Commission's authority over interstate traffic, contrary to the clear intent of Congress, and reducing the Commission's authority to establish a unitary intercarrier compensation regime. This is so because the procedural and pricing requirements of Section 252 govern all traffic subject to Section 251(b)(5). As a result, if the Commission were to subject interstate VoIP traffic to Section 251(b)(5), the Commission's role with respect to that traffic under Section 252(d)(2) would be limited to determining the pricing "methodology."[70] It is state commissions that will "implement that methodology, determining the concrete result in particular circumstances,"[71] and thus it is the state commissions that would be charged with establishing the rates for intercarrier

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through notice and comment rulemaking. The instant proceeding does not – and cannot – constitute a rulemaking because the Commission has not satisfied the requirements of Section 553 of the Administrative Procedure Act ("APA"). Under the APA, an agency may not conduct a rulemaking – and therefore may not promulgate regulations – unless it first issues a notice of proposed rulemaking ("NPRM"). *See* 5 U.S.C. § 553(b). But no NPRM with respect to VoIP access charges has issued here. In fact, the Public Notice in this docket makes no mention of the complex and interrelated questions at issue; instead, it announces that Level 3 has filed a forbearance petition, and instructs interested parties where they should send their comments. *See Pleading Cycle Established for Pet. of Level 3 for Forbearance*, Public Notice, DA No. 04-1 (Jan. 2, 2004).

70 *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 384 (1999).

71 *Id.*

compensation for VoIP service.[72] The Commission's role would be profoundly circumscribed by such a decision, seriously limiting its ability to establish a national, uniform compensation regime for interstate (or other) traffic.[73]

2. In addition to relinquishing jurisdiction over traffic that it has recently determined is preemptively interstate, granting Level 3's Petition also would require the Commission to prejudge issues currently pending in other proceedings and would risk undoing much of what the Commission has accomplished in recent years. For example, the Commission is currently considering the scope of Section 251(b)(5) in its ongoing proceeding on ISP-bound traffic. A decision here that Section 251(b)(5) extends to interstate interexchange traffic would prejudge the core issue in that proceeding and could lead to dramatically higher reciprocal compensation payments on ISP-bound traffic. As explained above, Level 3's Petition also would inflate those payments for an added reason. Because Level 3 would count VoIP minutes terminating on a local exchange carrier's network as part of the "1" in the 3 to 1 ratio used to determine if outbound traffic is subject to the lower federal rate for ISP-bound calls, it would mean that a greater volume of ISP-bound traffic would be subject to reciprocal compensation instead. In both respects, this would undo much of what the Commission accomplished in previous orders to limit the "uneconomic arbitrage" that resulted when states required the payment of reciprocal compensation on ISP-bound traffic. Accordingly, it would be wholly

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72 *See supra* note 69. The FCC also has no oversight over the terms and conditions of the interconnection agreements; that would govern compensation for this traffic; state regulatory commissions would be charged with arbitrating any disputes that arose in the interconnection agreement process.

73 With respect to interstate traffic, that result is flatly inconsistent with the 1996 Act. Section 251(i) of the Act provides that "[n]othing in . . . section [251] shall be construed to limit or otherwise affect the Commission's authority under section 201." But interpreting the Act to give state commissions authority for the first time to set rates for the exchange of *interstate* traffic necessarily would "limit" or "affect" the Commission's pre-existing authority over that traffic under Section 201.

arbitrary to grant Level 3's Petition now without first addressing the ramifications of the uneconomic arbitrage that would result.

Likewise, the Commission has spent much of the last two years disentangling itself from the harmful consequences of requiring local exchange carriers to make available TELRIC priced switching. Yet the effect of Level 3's Petition would ultimately be to reinstate that requirement for one particular type of traffic, despite the harmful consequences that the Commission has found it produced. As the Commission concluded, "competitive LECs have been unable to compete against other competitors using incumbent LECs facilities at TELRIC-based rates, and are thus discouraged from innovating and investing in new facilities."[74] Likewise, TELRIC priced switching "also has hindered the ability of competitors to use intermodal facilities for telephone customers," and "also creates disincentives for competitive LECs to use those competitive switches that have been deployed."[75]

3. The Commission also would need to determine whether the new rates would be adequate to provide just compensation under both the constitutional and statutory standards. [76] Under federal law, the Commission is charged with establishing and maintaining a mechanism by which LECs can recover the costs they incur as a result of interstate traffic

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74 *Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Dkt. No. 04-313, ¶ 220 (Feb. 4, 2005) ("*Triennial Review Order on Remand*").

75 *Id.*

76 The Commission's obligation under the APA to fully and fairly consider the issues presented is even greater in cases, like this one, where constitutional questions have been raised. *See Meredith Corp. v. FCC*, 809 F.2d 863, 874 (D.C. Cir. 1987) (holding that "the Commission must discharge its constitutional obligations by explicitly considering . . . claim[s] that . . . enforcement of" its policies constitute a "depriv[ation] . . .of . . . constitutional rights" and observing that the "Commission's failure to do so seems to us the very paradigm of arbitrary and capricious administrative action"); *see also National Treasury Employees Union v. FLRA*, 986 F. 2d 537 (D.C. Cir. 1993) (holding that the agency was not free to ignore the constitutional implications of its decisionmaking). It goes without saying that deference to agency interpretations does not apply when the Constitution is at issue. *See, e.g.*, *Bell Atlantic Tel. Co. v. FCC*, 24 F.3d 1441, 1443, 1445 (D.C. Cir. 1994).

traversing their networks. This duty is a function of both the statute, which requires the Commission to ensure that rates are "just and reasonable,"[77] and of the Constitution, which requires regulators to provide carriers with a mechanism that allows them to recover costs assigned to the interstate and intrastate jurisdictions respectively. As the Supreme Court long ago established in *Smith v. Illinois Bell Tel. Co.*, anything less would amount to an unconstitutional "confiscatory regulation of rates."[78] The Commission has discharged this duty previously by creating the access charge regime.[79] And the Commission on multiple occasions has confirmed that the existing access charge regime results in rates that are just and reasonable.[80] The Commission cannot now dramatically slash those rates unless it first determines that the replacement rates are just and reasonable and not confiscatory.

Here, granting Level 3's Petition would give VoIP providers the option of paying only the $0.0007 rate that applies to ISP-bound traffic. But Level 3 has made no effort to show that those rates would meet the statutory or constitutional standards in this context. Nor could it. The Commission has never found that the rates established in the *ISP Remand Order* are cost-based. Indeed, the Commission there acknowledged that those rates were *not* designed to allow carriers to recover their costs, and it did not seek to justify those rates on that basis: "the rates

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[77] 47 U.S.C. § 201.

[78] 282 U.S. at 160; *see also, e.g.*, *United States v. Pewee Coal Co.*, 341 U.S. 114, 117-18 (1951) (plurality opinion) ("When a private business is possessed and operated for public use, no reason appears to justify imposition of losses sustained on the person from whom the property was seized."); *FERC v. Pennzoil Producing Co.*, 439 U.S. 508, 517 (1979) (construing the Natural Gas Act to allow individual producers to recover their prudent costs of production).

[79] Indeed, the Commission itself in the past has expressly established systems "to ensure that the [compensation schemes] do[] not lead to . . . unreasonably low rates." *LEC Price Cap Order*, 5 FCC Rcd at 6807 (¶ 166); *see also, e.g.*, *United States Tel. Ass'n v. FCC*, 188 F.3d 521, 528 (D.C. Cir. 1999) (explaining that the Commission had "a good reason" for establishing a mechanism "to prevent [LECs'] returns from falling below a given level" – namely, "the Constitution's takings clause, which forbids the imposition of confiscatory rates without just compensation").

[80] *See supra* note 13.

caps we impose are not intended to reflect the costs incurred by each carrier that delivers ISP traffic."[81] Instead, it explained that CLECs "whose costs exceed those rates are (and will continue to be) able to collect additional amounts from their ISP customers,"[82] noting that "CLEC end-user recovery is generally not regulated"[83] and that, "[a]s non-dominant carriers, CLECs can charge their end-users what the market will bear."[84] ILECs, of course, have no such flexibility. Rather, as the Commission pointed out in the *ISP Remand Order*, "ILEC end-user charges, however, are generally regulated by the Commission, in the case of interstate charges, or by state commissions, for intrastate charges."[85]

Moreover, even if the Commission took steps to ensure that state-set reciprocal compensation rates apply, rather than the lower rate for ISP-bound traffic, Level 3 has made no effort to show that reducing access rates to TELRIC would meet the relevant standards either. Again, just the opposite is true. If Level 3's Petition were granted, the reciprocal compensation rates at which Verizon would be compensated would be substantially lower than the access charges the Commission has already found to be just and reasonable.[86] And the Commission previously rejected Level 3's argument that access rates should be set at the same level as reciprocal compensation.[87] Indeed, it previously has refused to prescribe rates based on forward-looking costs, let alone the even more extreme TELRIC formula.[88]

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81 *ISP Remand Order*, 16 FCC Rcd at 9156 (¶ 7); *see also id.* at 9190 (¶ 84) ("we make no finding here regarding the actual costs incurred in the delivery of ISP-bound traffic").

82 *Id.* at 9156 (¶ 7); *see also id.* at 9156 (¶ 8) ("Any additional costs incurred must be recovered from end-users.").

83 *Id.* at 9189 n.151 (¶ 80).

84 *Id.*

85 *Id.*

86 *See supra* note 13.

87 *See CALLS Order*, 15 FCC Rcd at 13,036-37 (¶ 178).

88 *See Access Charge Reform Order*, 12 FCC Rcd at 16,001-03 (¶¶ 44-49).

Nor would reducing access rates to TELRIC meet either statutory or constitutional standards. For example, Verizon's local telephone company serving New York is currently earning an interstate rate of return of *zero*, which means that its interstate rates already fall short of the constitutional minimum. Any further reduction in those rates could only exacerbate the problem. And it is no answer to say that VoIP services do not yet enjoy wide subscribership. The reality is that Cablevision alone now offers VoIP to more than 4 million homes in New York and is adding customers at the rate of 1,000 per day.[89] Still other providers also are marketing their services extensively in New York State and elsewhere as well.[90]

4. The Commission also could not craft a new compensation scheme for VoIP traffic without giving adequate consideration to the effect on universal service. Access charges allow local exchange carriers to recover the costs of the local network. Under the access charge regime, the heaviest users of the network pay a larger share of those costs. Recovering costs in this manner allows local exchange carriers to construct and maintain a network with a broad enough reach to serve all consumers, while keeping local telephone rates affordable.

At a minimum, the Commission would need to consider the financial and operational consequences on universal service if it exempted VoIP traffic from the access charge regime. And if, as even Level 3 admits would occur,[91] the creation of such an exemption resulted in a loss of revenues, the result would either be an increase in local service rates (to the extent that such increases are possible), or a reduction in network investment and maintenance. Because of the pernicious effects on universal service that slashing access charge revenues would have, the

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89 *See infra* note 122 and accompanying text.

90 *See infra* notes 123 to 132 and accompanying text.

91 Letter from John T. Nakahata, Counsel to Level 3 Communications LLC, to Marlene H. Dortch, Secretary, FCC, WC Dkt. No. 03-266, at 2 (Jan. 31, 2005) (acknowledging that the "exchange [of] IP-enabled traffic with the PSTN under reciprocal compensation mechanisms" will "lower" LECs' revenues).

Commission also would need to consider carefully the impact on universal service and how to offset the impact of those cuts. Indeed, the various intercarrier compensation reform proposals – including the one endorsed by Level 3 – explicitly have recognized that access rates cannot be slashed in isolation.[92] Any such reductions would require offsetting changes, such as increases in end user rates, to make up the shortfall. These issues, which require detailed study of the effects of various alternatives, cannot be properly considered in a forbearance proceeding.

5. The Commission also would need to decide a number of practical and technical issues if it were to grant Level 3's Petition. For example, the Commission would have to establish a mechanism to identify covered VoIP traffic and to differentiate it from the other voice traffic traveling over the PSTN.[93] Today, however, no such mechanism exists, and while various industry fora are working on aspects of the problem, there remain a number of complicated issues to be resolved.[94] Since Level 3's Petition does not apply to some rural

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92 Intercarrier Compensation Forum, *Intercarrier Compensation and Universal Service Reform Plan* at 48-68 (Oct. 5, 2004); Alliance for Rational Intercarrier Compensation, *Intercarrier Compensation Reform Plan* at 23-29 (Oct. 25, 2004) (discussing the effect of the Intercarrier Compensation Forum plan on SLCs and USF).

93 *See IP-Enabled Services NPRM*, 19 FCC Rcd at 4095 (¶ 62); *see also Ex Parte* Presentation of WilTel Communications, LLC, WC Dkt. No. 03-266, at 13 (Dec. 21, 2004) (explaining that the FCC could exempt VoIP traffic from access charges only if it established, among other things, mechanisms to "distinguish VoIP traffic from legacy traffic" and to detect "fraudulent manipulation of call data").

94 Level 3 has proposed using the Originating Line Identifier (OLI) Parameter to identify VoIP-originated calls. See Letter from John T. Nakahata, Counsel to Level 3 Communications LLC, to Marlene H. Dortch, Secretary, FCC, WC Dkt. No. 03-266 (Sept. 24, 2004). There are a number of issues with Level 3's proposal. For example, today, OLI is used by originating carriers to identify certain types of calls or classes of service for billing the originating carrier's customer. OLI is not an end-to-end parameter, and does not get recorded at the terminating end of the call. As another example, OLI is not populated on the SS7 Initial Address Message for local or IntraLATA calls. In addition, OLI today is used only on Feature Group D trunks. If Level 3's proposal were to be adopted, all industry participants – ILECs, CLECs, VoIP providers, IXCs – would need to expend significant time and resources to modify their systems and processes to use OLI in this new way. A number of industry committees are currently working on methods and standards for addressing this issue. Among these are the Ordering & Billing Forum (OBF) (Issue 2776: Identification of IP-Originated, PSTN-Terminated Traffic for Intercarrier Compensation Purposes) and the Network Interoperability Committee (NIOC) (Issue

carriers,[95] and because many carriers such as Level 3 rely on meet-point or transit services from non-rural LECs to deliver traffic that terminates on rural networks,[96] the Commission would need to establish rules governing the handoff of calls between large LECs and rural carriers. Absent sensible answers to these questions, no reciprocal compensation scheme could rationally be applied to VoIP traffic.

6. In recognition of the interrelatedness of these issues, Congress in the 1996 Act specifically preserved all pre-existing access charge requirements until they are expressly superseded by new rules. Thus, Section 251(g) of the Communications Act provides that access charges shall continue until they are "*explicitly* superseded *by regulations* prescribed by the Commission."[97] This requirement ensures that the interrelated issues of access charges, ensuring just and reasonable rates, and the adequacy of universal services are adequately considered in the context of a rulemaking. The forbearance proceeding initiated by Level 3 is not a rulemaking and cannot ensure that these issues are adequately considered.

Nor could the Commission shield its treatment of all these inter-related issues from the standards that apply to agency rulemaking by effectively adopting new rules in the guise of a forbearance order. The federal courts in an unbroken line of cases have seen through – and

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0246: Jurisdiction Information Parameter (JIP) Rules when VoIP technology is involved for some portion of the call). Other committees such as the Packet Technologies & Systems Committee and the Common Interest Group on Rating and Routing Forum are also working on aspects of this issue. These industry standards groups are the appropriate forum for development of the capability Level 3 seeks.

95 *See* Level 3 Pet. at 8 (excluding from its forbearance request "traffic exchanged between Level 3 and a LEC operating within the geographic service area of an ILEC that currently is exempt from Section 251(c) pursuant to Section 251(f)(1)").

96 *See, e.g.*, Letter from James C. Smith, Senior Vice President, SBC, to Michael K. Powell, Chairman, FCC, WC Dkt. No. 03-266, at 3 (Feb. 3, 2005) ("*SBC Ex Parte*") ("Rural carriers typically do not have direct interconnection arrangements with CLECs like Level 3. Rather, they rely on indirect interconnection through non-rural ILECs."); *see also* Verizon Telephone Companies Tariff F.C.C. No. 1, § 2.4.7 (Ordering, Rating and Billing of Access Services Where More Than One Exchange Telephone Company is Involved).

97 47 U.S.C. § 251(g) (emphases added).

rejected – similar "administrative law shell game[s]"[98] in which agencies seek to insulate their decisions from judicial review. For instance, in *Action for Children's Television v. FCC*,[99] this Commission shortened the time of day during which the broadcast of indecent, non-obscene material is proscribed, and brought three enforcement actions under that new standard. On appeal, the Commission urged the D.C. Circuit to review only the three specific agency holdings in which it determined the material to be indecent, not the content of the Commission's general indecency standard. The court rejected the Commission's position, and proceeded to scrutinize the agency's underlying substantive understanding of indecency. According to the D.C. Circuit, an "agency may not resort to adjudication as a means of insulating a generic standard from judicial review."[100]

The same is true here. The courts would scrutinize the lawfulness of the Commission's actions, and, as explained above, if the Commission were to ignore important parts of the regulatory problems it faces here, as Level 3 urges it to do, that action would be struck down as arbitrary and capricious.

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98 *AT&T Co. v. FCC*, 978 F.2d 727, 731-32 (D.C. Cir. 1992) (deriding as "a sort of administrative law shell game" the Commission's refusal to address the legality of an underlying agency regulation, and speculating that the Commission "wants to avoid judicial review of the rule" because it "fears the [policy] cannot withstand judicial scrutiny (at least in our court)").

99 852 F.2d 1332 (D.C. Cir. 1988), *superceded in part on other grounds*, 58 F.3d 654 (D.C. Cir. 1995) (en banc).

100 *Id*. at 1337; *see also Benavides v. Bureau of Prisons*, 995 F.2d 269, 272 (D.C. Cir. 1993) (invalidating a regulation enabling the Bureau to evade its Privacy Act obligation to disclose certain medical records by transferring them to a private doctor, and stressing that "[w]e cannot imagine that Congress would have intended to permit the government, through this sort of neat legal maneuver, to insulate a decision not to disclose documents to a requesting individual from federal judicial review"); *Ry. Labor Executives' Ass'n v. Nat'l Mediation Bd.*, 29 F.3d 655, 672-73 (D.C. Cir. 1994) (en banc) (Randolph, J., concurring) ("In light of the presumption in favor of judicial review and because there is no clear and convincing evidence, that Congress intended to insulate Board rulemaking from judicial scrutiny, the APA gives petitioners the right to a decision on the merits and the APA obligates this court to give it." (internal quotation marks and citations omitted)).

IV. THE CRITERIA OF SECTION 10 ARE NOT SATISFIED HERE.

In addition to being an inappropriate subject for forbearance to begin with, Level 3's Petition also would fail to satisfy the statutory criteria for forbearance even if they were to be applied. Of course, any attempt to apply the Section 10 criteria to Level 3's Petition necessarily is awkward. In a typical Section 10 proceeding, the Commission is considering whether to *refrain* from enforcing a regulation, and the question is whether rates for consumers will be reasonable and whether consumers will be protected if the regulation at issue is not enforced. But Level 3's Petition does not fit within the typical forbearance framework because it is asking the Commission to *increase* the regulation that applies to local exchange carriers. Nonetheless, when the Section 10 criteria are applied in light of the unique nature of the Petition here, none of these requirements is met.

A. Level 3's Petition fails the first of Section 10's criteria both because granting Level 3's Petition would result in unjust and unreasonable rates, and because it would discriminate among providers of voice long distance services.

1. As an initial matter, Level 3 has done nothing to carry its burden to show that the rates that would result from granting its application would be just and reasonable. Instead, Level 3's entire "showing" under the first prong of the forbearance test consists of a bold assertion that reciprocal compensation rates, when applied to VoIP traffic, are just and reasonable. They are not.

As explained above, the Commission has expressly found that existing interstate access charges, which are approximately $0.0055 when traffic is delivered at the tandem and lower if it is delivered at the end office, are just and reasonable. Yet the effect of Level 3's Petition would be to slash the rate that applies to one type of voice long distance traffic to the $0.0007 rate prescribed by the Commission for ISP-bound traffic. That represents a reduction of approximately *85 percent* from the current Commission-approved rate. Yet Level 3 makes no effort to justify that rate. Nor could it. As explained above, the rate was not intended to provide for full cost recovery. The Commission instead has observed that CLECs – unlike ILECs – could recover any additional costs directly from their end users.[101]

Similarly, Level 3 made no showing that state-set reciprocal compensation rates are just and reasonable when applied to the termination of interexchange calls. Nor has it tried to show that it would be reasonable to require LECs to forgo the access charges they *receive* today and instead *pay* reciprocal compensation on any VoIP traffic that originates on the PSTN and is still within the scope of Level 3's petition. TELRIC-based rates assume a hypothetical, ideally efficient network, are lower than any real-world carrier could match, and do not yield anything close to "just and reasonable" compensation for the costs incurred in providing access services.[102] The Commission has recognized that TELRIC produces UNE rates that are, in the words of Chairman Powell, "subsidized and below costs."[103] Indeed, the Commission noted in its *Triennial Review Order* that, even for an entrant that is wholly unencumbered by an existing

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[101] *See, e.g.*, *ISP Remand Order*, 16 FCC Rcd at 9156 (¶ 7) (explaining that CLECs "whose costs exceed these rates are (and will continue to be) able to collect additional amounts from their ISP customers"); *id.* at 9189 n.151 (¶ 80) (noting that "CLEC end-user recovery is generally not regulated"); *id*. (emphasizing that, "[a]s non-dominant carriers, CLECs can charge their end-users what the market will bear"); *id*. (indicating that "ILEC end-user charges . . . are generally regulated by the Commission, in the case of interstate charges, or by state commissions, for intrastate charges").

[102] *See, e.g.*, *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, 18 FCC Rcd 18,945, 18,949 (¶ 7) (2003) ("*TELRIC NPRM*") (noting the "excessively hypothetical nature of the TELRIC inquiry"); *id*. at 18,964 (¶ 51) (cautioning that state applications of TELRIC that "[s]imultaneously assum[e] a market inhabited by multiple competitors and one with a ubiquitous carrier with a very large market share may work to reduce estimates of forward-looking costs below the costs that would actually be found even in an extremely competitive market"); *id*. at 18,964 (¶ 52) (tentatively concluding "that our TELRIC rules should more closely account for the real-world attributes of the routing and topography of an incumbent's network in the development of forward-looking costs").

[103] Jeremy Pelofsky, *FCC Chief Denies Leaving, Outlines Media Agenda*, STAR-LEDGER (Aug. 19, 2003).

network and can take advantage of all the newest technologies and most efficient network configuration – and therefore enjoys a competitive *advantage* compared to an incumbent – "the costs of self-providing . . . elements [are] likely much higher than obtaining them from the incumbent priced at TELRIC."[104] Similarly, in a Policy Paper accompanying the *NPRM*, Commission Staff concluded that successive repricing based on a hypothetical network results in rates that understate costs.[105] As the paper states, "if investment costs are falling over time, and the period between TELRIC price adjustments is shorter than asset lives, then traditional TELRIC pricing will not permit incumbents to recover the cost of their investment."[106]

The Commission has initiated a proceeding to examine TELRIC, but has not yet adopted a revised methodology, so reciprocal compensation rates set in accordance with pre-existing interpretations of TELRIC do not reflect any of these corrections.

Finally, Level 3 has made no attempt to show that current access rates are not just and reasonable. Nor could it. Again, as explained in detail above, the Commission has determined that interstate access charges are "just and reasonable" and "within the range of estimated economic costs of switched access."[107] Indeed, the Commission has rejected arguments that

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104 *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 18 FCC Rcd 16,978, 17,304 n.1581 (¶ 517) (2003) ("*Triennial Review Order*").

105 David M. Mandy and William W. Sharkey, Dynamic Pricing and Investment from Statis Proxy Models, OSP Working Paper Series, No. 40 (Sept. 2003) ("*OSP Paper*").

106 *Id*. at 1

107 *CALLS Order*, 15 FCC Rcd at 13,035 (¶ 176). To the extent other parties pin their support for Level 3's Petition on the supposedly excessive level of interstate access charges, the Commission has rejected that argument. In the *AT&T Phone-to-Phone IP Order*, the Commission concluded that, until such time as it changes its access charge regime, access charges remain the mechanism for compensating LECs for the use of their facilities to originate or terminate interstate telecommunications services. *See AT&T Phone-to-Phone IP Order*, 19 FCC Rcd at 7469 (¶ 18) ("The Commission currently is considering access charge reform in its *Intercarrier Compensation* proceeding, and any issues raised by current access rate levels or rate structures will be addressed there, on the basis of a detailed record. Until such time, however, interstate access charges are the charges assessed on interexchange carriers that use local

access rates should be set based on forward-looking costs, as well as arguments by Level 3 and others that switched access rates should be set at the same level as reciprocal compensation under Section 251(b)(5).[108]

Level 3 likewise has failed to show that forbearance from applying access charges is necessary to ensure consumers receive just and reasonable rates. Access services are an input to long distance services provided to consumers. Under the current access charge framework, end user long distance rates undeniably are just and reasonable. The Commission repeatedly has found that there is substantial competition in the long distance market (for which access charges are an input), to the great benefit of consumers.

While Level 3's Petition includes a great deal of rhetoric arguing that having to pay access charges would somehow preclude VoIP providers from competing, and thereby stymie the development of a new technology, the *facts* tell a very different story. Carriers will pay approximately $1.00 more per line per month if they pay access charges on VoIP traffic than if they pay the $0.0007 rate for ISP-bound traffic. This calculation compares the amount VoIP providers (or their CLEC partners) would pay per line in terminating access charges to the amount they would pay per if they paid reciprocal compensation on terminating traffic, using the same minute of use assumptions that the Commission used when reviewing 271 applications. Vonage offers unlimited local and long distance calling for only $24.99 per month, AT&T's CallVantage service provides unlimited calling for only $29.99,[109] and Time Warner and

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exchange switching facilities for the provision of interstate telecommunications services." (footnotes omitted)).

108 *See CALLS Order*, 15 FCC Rcd at 13,036-37 (¶ 178); *Access Charge Reform Order*, 12 FCC Rcd at 16,001-03 (¶¶ 44-49).

109 *See Wireline Services Pricing Update*, Banc of America Securities Research Brief, Jan. 12, 2005, at 3 (on file with Verizon).

Comcast have unlimited local/long distance calling plans priced below $40.00 per month.[110] An additional dollar a month will still permit VoIP providers to offer consumers rates substantially below the comparable plans that circuit switched providers offer (which typically cost between $45.00 and $55.00 a month).[111]

Even though the impact of denying the petition would be *de minimis* for VoIP providers, granting the petition would have a large, negative impact on local exchange carriers. This is because local exchange carriers would receive $1 less per month *for every VoIP line*. And, as explained in more detail below, the number of VoIP lines provided by cable operators, large IXCs, and small niche players, are growing exponentially.

2. Granting Level 3's Petition also would result in unreasonable discrimination. In particular, granting Level 3's Petition would mean that local exchange carriers would receive substantially lower compensation from some providers of voice long distance service than others. This disparate treatment would be based solely on the fact that their services employ a different transmission protocol *before* being converted and handed off for delivery on the PSTN in the same manner as any other long distance call. This disparity undermines the Commission's fundamental "belie[f] that any service provider that sends traffic to the PSTN should be subject to similar compensation obligations, irrespective of whether the traffic originates on the PSTN, on an IP network, or on a cable network" and that "the cost of the PSTN should be borne equitably among those that use it in similar ways."[112] As the Commission

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110 *Id.* at 6, Table ("Entry-Level Triple-Play Pricing by Carrier (Video, Voice, and Broadband)").

111 *Id.*

112 *IP-Enabled Services NPRM*, 19 FCC Rcd at 4904 (¶ 61); *see also ISP Remand Order*, 16 FCC Rcd at 9167 n.63 (¶ 36) (explaining that "one of the Commission's primary goals when designing an access charge regime was to ensure that access users were treated in a nondiscriminatory manner when interconnecting with LEC networks in order to transport interstate communications").

explained in the *AT&T Phone-to-Phone IP Order*, Level 3 "obtains the same circuit-switched interstate access for its specific service as obtained by other interexchange carriers."[113] Therefore, Level 3's "specific service imposes the same burdens on the local exchange as do circuit-switched interexchange calls. It is reasonable that [Level 3] pay the same interstate access charges as other interexchange carriers for the same termination of calls over the PSTN, pending resolution of these issues in the *Intercarrier Compensation* and *IP-Enabled Services* rulemaking proceedings."[114]

Nor is there any justification for treating voice long distance services differently for compensation purposes.[115] To be sure, there are reasons to treat VoIP differently for some purposes. Both VoIP and the broadband facilities and services on which they ride are available from multiple providers and are fully competitive. For that reason, VoIP and broadband services should not be subject to economic regulation. But the issue here is very different. The question here is what compensation local exchange carriers should receive when voice long distance providers use their local network in the same way. And on that issue there is no basis to discriminate based on the identity of the provider.[116]

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[113] *AT&T Phone-to-Phone IP Order*, 19 FCC Rcd at 7466 (¶ 15).

[114] *Id.* at 7467 (¶ 15).

[115] Section 202 of the Act prohibits "any unjust or unreasonable discrimination in charges . . . for . . . like communication service," and the D.C. Circuit has made clear that the Commission's regulations must comply with Section 202 and must not discriminate "between similarly situated phone services without a rational basis." C*.F. Communications Vending Corp. v. FCC*, 128 F.3d 735, 740 (D.C. Cir. 1997). In *C.F. Communications*, the D.C. Circuit vacated the Commission's decision to impose end user common line charges ("EUCLs") upon independently owned, but not ILEC-owned, payphone providers. *Id.* In its holding, the court explained that the two kinds of payphones "provided indistinguishable telephone service" and there was no rational basis for the Commission to impose charges only upon the independent payphone operators. *See C.F. Communications Vending Corp. v. FCC*, 365 F.3d 1064, 1068 (D.C. Cir. 2004).

[116] Likewise, nothing in the *Vonage Order* suggests that it is permissible to discriminate between long distance calls where one of the end users uses VoIP technology and traditional circuit-switched long distance calls. The *Vonage* decision holds that, because it is impossible to separate the interstate and intrastate components of VoIP traffic and the application of state

Likewise, the Petition would engender discrimination between rural and non-rural ILECs (and between different groups of rural ILECs). Level 3 excludes from its forbearance requests "traffic exchanged between Level 3 and a LEC operating within the geographic service area of an ILEC that currently is exempt from Section 251(c) pursuant to Section 251(f)(1)."[117] But non-rural LECs, like rural LECs, use access charges to help operate and maintain the network. Level 3 offers no justification for distinguishing between the two in this context.

Finally, Level 3's recent "clarification" of its forbearance request would create a third form of discrimination. Level 3, a CLEC in its own right, would continue to *collect* access charges from long distance carriers for interexchange traffic that originates on the PSTN and is transported by an IXC to Level 3 for termination to a VoIP end user. But Level 3 would avoid *paying* access charges when calls originate in IP and terminate on the PSTN.[118]

B. Level 3's Petition also fails the second of the Section 10 criteria because the continued application of access charges to VoIP traffic is necessary to protect consumers and to preserve universal service obligations, at least until the Commission addresses more comprehensive intercarrier compensation and universal service reform.

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regulation would negate valid federal policies, this jurisdictionally mixed service will be considered interstate and exempted from state entry and rate regulation. *See Vonage Holdings Corp.*, 19 FCC Rcd 22,404, 22,404-05 (¶ 1) (2004). That is an entirely different question from whether long distance carriers using VoIP on one end should be allowed to avoid access charges that apply to all other long distance carriers. Indeed, while it is impossible to determine the jurisdictional nature of every individual VoIP call, it is possible to estimate the percentage of VoIP calls that are interexchange and subject to access, at least as an interim measure until the Commission addresses intercarrier compensation more broadly.

117 Level 3 Pet. at 8.

118 *See SBC Ex Parte* at 1-2 (objecting that Level 3 has sought "to avoid the lawful assessment of access charges by routing [VoIP-to-PSTN] traffic to the PSTN over local interconnection trunks rather than access trunks," while simultaneously, "in the case of interexchange PSTN-to-VoIP traffic, . . . collect[ing] access charges from wireless providers and long distance providers").

As explained above, interstate access charges are intended to allow LECs to "recover the costs of providing interstate access services."[119] They have helped pay for ubiquity and have helped keep end-user charges affordable. Indeed, Chairman Powell has "fully recognize[d] the gravity of any decision that might cause a precipitous decline in access charge revenues and a concomitant impact on universal service."[120] Because granting Level 3's Petition would reduce access charge revenues, either end user rates would have to increase (if possible) or investments in local exchange networks would suffer. Neither result would comport with section 10's mandate to protect consumers.

Level 3 has made no effort to show that applying reciprocal compensation rates rather than access charges to the traffic at issue would not have an adverse impact on universal service. Nor has it shown that forbearing from applying access charges is necessary to protect consumers. Rather, it seeks to minimize universal service concerns by speculating that VoIP will constitute only four percent of circuit-switched revenues in 2006; it claims, therefore, that there is no evidence that granting Level 3's Petition will "disrupt universal, affordable, and reasonably comparable telephone services."[121]

But VoIP use is growing exponentially, and granting Level 3's Petition will increase the speed of that growth. Today, anyone with a broadband connection – and broadband is available to more than 90 percent of the households across the country – can obtain VoIP service from a multitude of providers. The major cable operators are aggressively rolling out VoIP and are expected to offer this service to almost all of their in-franchise homes within the next two to three years. In fact, Cablevision already offers VoIP to the 4 million cable homes that it passes

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119 *CALLS Order*, 15 FCC Rcd at 13,015 (¶ 130).

120 *Powell VoIP Statement* at 15.

121 Level 3 Pet. at 50.

in the metropolitan New York area and in New Jersey, and has been adding nearly 1,000 new customers each day.[122] Time Warner has launched VoIP in all 31 of its markets, which cover a total of 18.8 million homes in 27 states,[123] with "great results" – over 200,000 subscribers as of the close of 2004 with net "adds" of 11,000 subscribers per week "and ramping up."[124] Cox offers VoIP service in several markets, including Virginia, Louisiana, Oklahoma, and Texas.[125] Comcast intends to market VoIP service to 15 million homes by year-end, and to all 40 million homes that it passes by the end of 2006, and it expects a 20 percent penetration rate in five years, with a 40 percent operating margin.[126]

Where cable companies offer VoIP, they have enjoyed great success. Analysts predict that cable operators will capture 10 percent of current residential lines by 2007 and over 15 percent by 2008. And individual companies such as Time Warner already are beating those estimates; 40 percent of Time Warner's cable modem customers in Portland, Maine (roughly 14 percent of all homes passed in the city) purchase Time Warner's VoIP service, and Time Warner

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122 *See* Cablevision, *Cablevision's Optimum Voice® Surpasses 250,000 Customers* (Dec. 7, 2004), *available at* http://www.cablevision.com/index.jhtml?id=2004_12_07.

123 J. Hodulik *et al.*, UBS, *TelMeDaily – US Version* at 2 (Jan. 5, 2005); Time Warner Cable, *About Us*, *available at* http://www.timewarnercable.com/corporate/aboutus/?menu=Aboutus.

124 Wayne Pace, EVP & CFO, Time Warner Inc., Remarks before the 15th Annual Entertainment, Media & Telecommunications Conference, Phoenix, Arizona, at slide 17 (Jan. 11, 2005).

125 Cox News Release, *Cox Communications Delivers Cox Digital Telephone to 12th Market; Roanoke, VA. Marks Cox's First Market Launch of VoIP Technology* (Dec. 15, 2003), *available at* http://phx.corporate-ir.net/phoenix.zhtml?c=76341&p=irol-newsArticle&t=Regular&id=477594&; Cox News Release, *Cox Communications Delivers Digital Telephone Service to Southwest Louisiana; Southwest Louisiana Marks 17th Telephone Market for Cox* (Nov. 15, 2004), *available at* http://phx.corporate-ir.net/phoenix.zhtml?c=76341&p=irol-newsArticle&t=Regular&id=644050&.

126 *CMCSA – Comcast Corporation at Citigroup 15th Annual Entertainment, Media and Telecommunications Conference*, Thomson Street Events, Final Transcript at 5 (Jan. 10, 2005) (statement by Comcast Corp. CEO and Chairman Brian L. Roberts); Comcast Corp. Presentation at the 15th Annual Smith Barney Citigroup Entertainment, Media and Telecommunications Conference at 15 (Jan. 10, 2005); Comcast, *Factsheet*, *available at* http://www.cmcsk.com/phoenix.zhtml?c=147565&p=irol-factsheet.

is adding 10,000 VoIP customers per week in its markets "despite the fact that the company has not yet started marketing the product aggressively in several metros."[127] Likewise, Cox Cable reports that its VoIP penetration is ramping up as quickly as its circuit-switched telephony did – and its penetration rate for the latter service now averages 20 percent and in some cases exceeds 55 percent.

Cable companies are not the only carriers providing VoIP. AT&T, for example, now makes its CallVantage service available to 62 percent of U.S. households, in 170 markets in 39 states and the District of Columbia.[128] Although AT&T has yet to publicly disclose the results of its effort, analysts estimate that after just nine months of service, AT&T already had garnered approximately 150,000 VoIP subscribers.[129] And Vonage, which already serves more than 400,000 subscribers, is adding 30,000 new subscribers each month,[130] and is on track to acquire one million subscribers by the summer of 2005,[131] and numerous companies are using Level 3's wholesale VoIP platform. VoIP, in short, is a rapidly growing presence in the marketplace, and granting Level 3's Petition could affect the quality and affordability of basic phone service.[132]

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[127] J. Hodulik *et al*., UBS Investment Research, *US Telco Wake-Up Call* at 2 (Dec. 8, 2004) (emphasis omitted). Similarly, Cablevision states that it is adding 1,000 VoIP customers per day. S. Ricks, ABN-AMRO, *Verizon Communications: Reduce to Marketweight on Valuation, Rising Competition* at 2 (Dec. 14, 2004).

[128] AT&T News Release, *AT&T Introduces New Residential VoIP Plan* (Oct. 14, 2004) (on file with Verizon); AT&T News Release, *AT&T Makes AT&T CallVantage Service "Family Friendly"* (Dec. 16, 2004) (on file with Verizon).

[129] *See* C. Larsen, Prudential Equity Group, LLC, *Telecom Services & Cable: We Expect Consumer VoIP Subs To Exceed 1M by Year-End* at 1 (Dec. 7, 2004) (on file with Verizon).

[130] Vonage Press Release, *Vonage Crosses 400,000 Line Mark* (Jan. 5, 2005), *available at* http://www.tmcnet.com/usubmit/2005/Jan/1105240.htm.

[131] M. Stump, *Vonage Hits the Shelves; VoIPer Adds Retail To Keep Up Growth*, Multichannel News at 63 (Oct. 11, 2004) (on file with Verizon).

[132] In any event, even if Level 3's prediction that VoIP will amount to only four percent of circuit-switched revenues were correct, this still represents lost revenues exceeding one hundred million dollars.

Moreover, granting Level 3's Petition could have serious implications for universal service apart from the reduction in access charge revenues. Level 3 observes that the Commission remains free to subject VoIP traffic to contribution requirements, and it further notes that the Commission is considering what universal service contribution obligations should apply to IP-based service providers.[133] But the Commission cannot make those determinations in a forbearance petition.

Finally, exempting VoIP traffic would *create* subsidies by forcing one class of customers (who will continue to pay access charges) to bear costs properly attributable to another class (those using IP-originating telephone service from Level 3 and similar providers). Chairman Powell has recognized that TELRIC, which would be used to determine reciprocal compensation charges for VoIP traffic, produces rates that are "subsidized and below costs."[134] Similarly, the Commission, in the *Triennial Review Order*, acknowledged that "the costs of self-providing . . . elements [are] likely much higher than obtaining them from the incumbent priced at TELRIC."[135] The Commission properly has refused to grant forbearance when doing so would result in a subsidy.[136] Indeed, the Commission has no discretion to do otherwise, because establishing an implicit subsidy for Level 3's services would violate 47 U.S.C. § 254.

For all of these reasons, the forbearance sought by Level 3 would harm consumers.

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133 Level 3 Pet. at 53. IP-based carriers might construe a Commission decision excluding this service from access charges as a license to withhold universal service contributions as well.

134 *Quoted in* Jeremy Pelofsky, *FCC Chief Denies Leaving, Outlines Media Agenda*, STAR-LEDGER (Aug. 19, 2003).

135 *Triennial Review Order*, 18 FCC Rcd at 17,304 n.1581 (¶ 517) (acknowledging that "the costs of self-providing . . . elements [are] likely much higher than obtaining them from the incumbent priced at TELRIC").

136 *See Pet. for Forbearance from Enforcement of Sections 54.709 and 54.711 of the Commission's Rules by Operator Communications, Inc. D/B/A Oncor Communications, Inc.*, 16 FCC Rcd 4382 (2001) (refusing to forbear from applying universal service contribution requirements to carriers with declining revenues).

C. Level 3's Petition also fails the third of Section 10's criteria because exempting VoIP traffic from access charges would not be in public interest for several reasons. As explained in detail above, it would yield unjust and unreasonable rates, create unreasonable discrimination among services and service providers that use the PSTN in the same way, undermine universal service, and prevent the Commission from carefully considering, and resolving in a coordinated fashion, the myriad potential consequences of altering the existing intercarrier compensation framework.[137]

Granting Level 3's Petition would disserve the public interest in other respects, as discussed below – it would distort long distance competition by playing technological favorites, inflate payments on ISP-bound traffic (which the Commission already has found is *not* in the public interest), and subject IP traffic and services to state jurisdiction, creating a patchwork of conflicting rules.

1. Although Level 3 claims that granting the relief it seeks would promote competition, innovation, and investment,[138] the opposite is true. Excluding VoIP traffic from access charges would violate fundamental principles of competitive neutrality by treating IP-based long distance carriers more favorably than circuit-switched long distance carriers. As the Commission has emphasized, "competitively neutral rules will ensure that . . . disparities are minimized so that no entity receives an unfair competitive advantage that may skew the marketplace or inhibit competition by limiting the available quantity of services or restricting the entry of particular service providers."[139]

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137 *See supra* notes 70 to 100 and accompanying text.

138 Level 3 Pet. at 38.

139 *See Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776, 8802 (¶¶ 48-49) (1997) ("We anticipate that a policy of technological neutrality will foster the development of competition").

This holds equally true in the forbearance context: "consideration of any request for forbearance, as a general matter, is technology-neutral and therefore does not turn on the asserted qualitative merits of a proponent's technology."[140] Keeping IP-based providers on the same footing as other long distance carriers with respect to access charges will help ensure that competition is not artificially skewed in favor of any one technology, consistent with the "technology neutral goals of the Act and with Congress' aim to encourage competition in all telecommunications markets."[141] Conversely, as the Commission has warned, "we see no benefit in promoting one party's use of a specific technology to engage in arbitrage at the cost of what other parties are entitled to under the statute and our rules."[142] In other words, competitive neutrality – not regulatory favoritism – is the best way to promote innovation and investment.

Nor has Level 3 even attempted to show that paying access charges for VoIP traffic would have any appreciable negative impact on innovation and investment in IP-enabled technology. Mere unsupported speculation is not sufficient to justify forbearance, as the recent *Core Forbearance Order* makes clear.[143] And, in any event, the analysis outlined above demonstrates that applying access charges to VoIP services (as they already apply to all other voice long distance services) would not undermine their competitiveness or deployment.[144]

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140 *Amendment to Parts 1, 2, 27 and 90 of the Commission's Rules to License Services in 216-220 MHz, 1390-1395 MHz, 1427-1429 MHz, 1429-1432 MHz, 1432-1435 MHz, 1670-1675 MHz and 2385-2390 MHz Government Transfer Bands*, 17 FCC Rcd 9980, 10,012 (¶ 80) (2002).

141 *See Deployment of Wireline Services Offering*, 15 FCC Rcd 385, 390 (¶ 12) (1999).

142 *AT&T Phone-to-Phone IP Order*, 19 FCC Rcd at 7468 (¶ 17).

143 *Pet. of Core Communications, Inc. for Forbearance Under 47 U.S.C. § 160(c) from Applications of the ISP Remand Order*, 19 FCC Rcd 20,179, 20,188 (¶ 25) (2004) ("*Core Forbearance Order*"). Similarly, the Commission has rejected a claim that the denial of forbearance would "lead to increased carrier and consumer costs" where the petitioner had "not presented any data or detailed cost-benefit analysis to support this assertion." *Pet. for Forbearance from Further Increases in the Numbering Utilization Threshold*, 18 FCC Rcd 13,311, 13,319 (¶ 16) (2003).

144 There is no reason to believe that applying access charges instead of reciprocal compensation to VoIP traffic would have more than a *de minimis* impact on IP providers. The

Finally, Level 3's speculation as to future changes to the inter-carrier compensation rules is irrelevant as well. In suggesting that subjecting VoIP traffic to reciprocal compensation rather than access charges is a reasonable transition to the new inter-carrier compensation rules, Level 3 invites the Commission to pre-judge the outcome of a proceeding for which it has only recently adopted a Notice of Proposed Rulemaking. This, the Commission may not do.

2. Granting Level 3's Petition also would inflate arbitrage payments on ISP-bound traffic, in violation of the *ISP Remand Order*. As explained above, Level 3 argues that any VoIP traffic handed off to a local exchange carrier should count toward the "1" in the 3:1 ratio adopted in the *ISP Remand Order* as a means of presumptively identifying ISP-bound traffic.[145] This would mean that a larger volume of traffic that is ISP-bound would fall within the 3 to 1 ratio and would be subject to payment of reciprocal compensation. Such a result would be directly contrary to the *ISP Remand Order*, which sought to "limit the regulatory arbitrage opportunity presented by ISP-bound traffic," because it "distorts competition by subsidizing one type of service at the expense of others."[146]

3. The Petition would subject IP traffic and services to a patchwork of conflicting state rules. As explained above, a decision that VoIP traffic is governed by Section 251(b)(5) would mean that these services would be covered by the TELRIC rate provisions as well as the interconnection arbitration and review provisions of Section 252. *From a policy perspective, this* would make it impossible for the Commission to establish a new, nationwide

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difference between paying terminating access charges and reciprocal compensation on terminating traffic is only about $1.00 per line.

145 Specifically, the Commission presumes that any traffic below the 3:1 ratio of terminating to originating traffic is local traffic subject to reciprocal compensation, and that any traffic above that ratio is ISP-bound traffic subject to a lower compensation rate. *ISP Remand Order*, 16 FCC Rcd at 9187-88 (¶ 79).

146 *Id.* at 9153, 9155 (¶¶ 2, 5).

intercarrier compensation regime that includes VoIP traffic. Likewise, service providers would almost certainly find themselves subject to a hodgepodge of different rate levels and rules on a state-by-state basis. As the Commission itself has recognized, this prospect inevitably would complicate the task of planning for and introducing nationwide services and would divert resources to compliance that otherwise would flow to innovation and investment.

V. CONCLUSION

For the foregoing reasons, the Commission must deny Level 3's Petition.

Respectfully submitted,

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